

INSTRUCTIONS—FORM 765

2004 KENTUCKY PARTNERSHIP INCOME RETURN

WHO MUST FILE—Any partnership, syndicate, group, pool, joint venture or limited liability company electing partnership treatment which derives income from property located in Kentucky or does business in Kentucky must file a partnership return on Form 765.

WHEN TO FILE

Taxpayers must file within three months and 15 days after the close of their taxable year.

NOTICE—NONRESIDENT WITHHOLDING

For taxable years ending on or after December 31, 2003, under the provisions of Regulation 103 KAR 18:070, every pass-through entity required to file Form 765, Kentucky Partnership Income Tax Return, or 720S, Kentucky S Corporation Income and License Tax Return, must withhold income tax at the rate of 6 percent on the net distributive share income of each Kentucky nonresident **individual** partner, shareholder, or member. See **Section III instructions**.

INCOME/DEDUCTIONS TO BE REPORTED—The income and deductions of a Kentucky partnership are determined under the Internal Revenue Code in effect December 31, 2001, except for differences provided in KRS 141.010 and 141.206. Differences include but are not limited to:

- (1) Exclude interest income from U.S. government obligations.
- (2) Include interest income from obligations of other states and their political subdivisions.
- (3) Exclude the 30 and 50 percent special depreciation allowance and the additional Section 179 deduction.

For additional instructions for reporting income and deductions, see federal instructions, Form 1065.

INTERNAL REVENUE CODE DEFINED—Kentucky income tax law is based on the federal Internal Revenue Code in effect on December 31, 2001. The Department of Revenue generally follows the administrative regulations and rulings of the Internal Revenue Service in those areas where no specific Kentucky law exists.

► ATTACH A COPY OF FEDERAL FORM 1065 AND ALL SCHEDULES.

SPECIFIC INSTRUCTIONS—The Kentucky Form 765 begins with ordinary income (loss) reported on federal Form 1065, Line 22. Report adjustments to federal ordinary income (loss) on Form 765, **Lines 2, 3, 5, 6 and 7**. See instructions for Lines 2, 6 and 7 for reporting differences in depreciation and basis for assets purchased after September 10, 2001. Prepare a schedule of other differences in federal ordinary income (loss) and report on Lines 3 and 7.

Reporting Depreciation Differences—Important: Use **Lines 2 and 6 only** if the partnership has elected for federal income tax purposes to take the special depreciation allowance. For separately stated Distributive Share Items, compute Kentucky income and enter on page 2, Schedule K, Section I.

All others attach a copy of the federal Form 4562 filed for federal income tax purposes to verify that no adjustments are required.

Line 2—The amount from Line 22 of the federal Form 4562 must be entered on Line 2, Form 765 and the federal Form 4562 filed for federal income tax purposes must be attached to Form 765.

Line 6—Create a Kentucky Form 4562 by entering **Kentucky** at the top center of a federal Form 4562 above Depreciation and Amortization. In Part I, replace the \$102,000 maximum amount on Line 1 with the Kentucky limit of \$25,000 and replace the \$410,000 threshold amount on Line 3 with the Kentucky phase-out threshold of \$200,000. In Part II, strikethrough and ignore Line 14, Special depreciation allowance for qualified property placed in service during the tax year. Use the created Kentucky Form 4562 to compute Kentucky depreciation and Section 179 deduction in accordance with the IRC in effect on December 31, 2001. Attach the created Kentucky Form 4562, and enter the amount from Line 22 on Line 6.

Reporting Differences in Gain or Loss From Disposition of Assets—If the partnership disposes of assets during the year on which the special depreciation allowance or increased Section 179 deduction was taken for federal income tax purposes, determine and report the difference in the amount of gain or loss on such assets as follows:

Line 7—Create a Kentucky form by entering **Kentucky** at the top center of a federal Schedule D, federal Form 4797 and other applicable federal forms. Compute Kentucky gain or loss from the disposed assets using the Kentucky basis. Enter the difference in ordinary income from federal gain or loss and the Kentucky gain or loss on page 1, Line 7, and enter all other Kentucky gains or losses on page 2, Schedule K, Section I. Attach the created Kentucky Schedule D, Kentucky Form 4797 and other forms or schedules to Form 765 as necessary.

Reporting Section 179 Deduction Differences, Schedule K, Line 9—The additional New York Liberty Zone deduction for property placed in service after September 10, 2001, and the increased deduction limits and thresholds for property placed in service after December 31, 2002, are not allowable for Kentucky tax purposes. Enter the Section 179 deduction allowable under the IRC in effect on December 31, 2001, on Schedule K. **NOTE:** In determining the Section 179 deduction for Kentucky, the income limitation on Form 4562, Line 11 is Kentucky net income before the Section 179 deduction instead of federal taxable income.

SCHEDULES K and K-1—Complete Kentucky Schedule K, Section II and Schedule K-1 for all nonresident partners. Kentucky Schedules K and K-1 are to be completed for resident partners only if the amounts to be reported are different from the amounts reported on the federal Schedules K and K-1.

RECAPTURE OF IRC SECTION 179 DEDUCTIONS—Furnish each partner a schedule showing the amount of IRC Section 179 expense subject to recapture that was originally passed through to the partners. Include the partnership's

tax year in which the amount was passed through for tax purposes. Inform the partner if the recapture amount was caused by the disposition of the recovery property.

LIABILITY OF PARTNERS—Partnerships are exempt by law from Kentucky income tax. However, **partners of partnerships doing business in Kentucky must report their share of income for Kentucky income tax purposes.** This applies to individuals, trusts, estates and corporations. Individuals who are Kentucky residents are required to file Form 740 and report their share of partnership income earned within or without Kentucky. Nonresidents may choose to file Form 740-NP and report their distributive share of income from partnerships doing business in Kentucky.

COMBINED OR COMPOSITE RETURN—For taxable years beginning on or after January 1, 2004, the Kentucky Department of Revenue will **not** recognize the filing of a "composite return." The filing of Form 740NP-WH is required and separate filings by the individuals are necessary to take advantage of the graduated tax rates.

LINE 13, KENTUCKY UNEMPLOYMENT TAX CREDIT—Partnerships must complete and attach Schedule UTC to compute the total credit. Compute each partner's distributive share to be entered on Schedules K and K-1, Line 13. The distributive share is determined by multiplying the total credit on Schedule UTC, Line 31, times the percentage of each partner's share of the partnership profits and losses. See Schedule UTC for further instructions.

LINE 14, RECYCLING AND COMPOSTING EQUIPMENT TAX CREDIT—Attach a copy of Schedule RC approved by the Department of Revenue to the partnership's return for the year during which the equipment was purchased. The total amount of the approved credit should be entered on Schedule K. The partnership must compute each partner's distributive share of the total approved credit reflected on Schedule K by completing Parts I and II of Schedule RC (K-1), Pro Rata/Distributive Share of Approved Recycling and/or Composting Equipment Tax Credit. A copy of the completed Schedule RC (K-1) should be provided to each partner with their Schedule K-1 (Form 765).

LINE 15, OTHER CREDITS—The total amount of the approved credit should be entered on Schedule K. The partnership must compute each partner's distributive share of the total approved credit.

Kentucky Investment Fund—Attach a copy of the certification from Kentucky Economic Development Finance Authority (KEDFA).

Bluegrass Skills Training Corporation—Attach a copy of the final authorizing resolution from the Bluegrass Skills Corporation.

Coal Incentive Tax Credit—Attach a copy of the credit certificate issued by the Department of Revenue.

Qualified Research Facility Tax Credit—Attach a copy of Schedule QR.

Employer GED Incentive Tax Credit—Attach completed Forms DAEL-31 for each employee that completed a learning contract during the taxable year.

SCHEDULE K, SECTION II

A partnership which has all of its property and payroll within Kentucky does not make the computation in Section II, Lines 3, 4 and 5, and must enter 100 percent on Schedule K-1 (Form 765), Item D(2). A partnership which has property or payroll both within and without Kentucky must compute the percentage of its gross receipts from sales to purchasers or customers in Kentucky or services performed in Kentucky to its gross receipts from sales or services everywhere during the tax year. The terms "sales" or "services" mean all gross receipts derived from transactions or activities in the ordinary and regular course of the partnership's trade or business and which are includible in its gross income. Interest, dividends, royalties and gains or losses on the disposition of property acquired, held, owned or used in the **ordinary or regular course of the partnership's business** are gross receipts used to determine the business ratio. Gross receipts of this kind are included in the Kentucky receipts portion (numerator) of the business ratio if the partnership is domiciled in Kentucky or the source of such income is in Kentucky. If the partnership is domiciled outside of Kentucky but the source of such income is in Kentucky, the gross receipts are in the numerator of the business ratio. The denominator of the business ratio is the total gross receipts in the ordinary or regular course of the partnership's trade or business.

Gross receipts, for determining the business ratio, do not include in either the numerator or the denominator interest, dividends, royalties and gains or losses on the disposition of property held for **other than trade or business purposes.**

WITHHOLDING—For taxable years ending on or after December 31, 2003, under the provisions of Regulation 103 KAR 18:070, every pass-through entity required to file Form 765, Kentucky Partnership Income Tax Return, or 720S, Kentucky S Corporation Income and License Tax Return, must withhold income tax at the rate of 6 percent on the net distributive share income of each Kentucky nonresident **individual** partner, shareholder, or member. However, for those Kentucky nonresident members whose net distributive share income is less than \$1,000 no withholding is required. The pass-through entity is liable for the payment of the tax required to be withheld less any credits passed through to the individual that are reasonably expected to be claimed in the current tax year.

The reporting of net distributive share income and payment of tax due by the pass-through entity shall satisfy the filing requirement of KRS 141.206 for a Kentucky nonresident individual member (Form 740-NP) whose only Kentucky source income is net distributive share income. The Kentucky nonresident individual member may file a return to take advantage of the graduated tax rates and apply the tax withheld against tax imposed for the taxable year in which the income is reported.

SECTION III

LINE 1—Enter the total nonresident partners' net distributive share of taxable income determined from Lines 1 through 17 of the return and any supplemental income and expense items. Enter here and report this amount on Form 740NP-WH, Line 6. Form 740NP-WH is available on the Kentucky Department of Revenue's Web site at www.revenue.ky.gov.

LINE 2—Enter the total amount withheld by the partnership on the net distributive share of the Kentucky nonresident partners. The amount withheld is Line 1 multiplied by 6 percent less applicable credits available for the taxable period.

Partnerships having Kentucky nonresident partners with net distributive share income of \$1,000 or more **shall** complete Form PTE-WH and mail Copy A with Form 740NP-WH, to the Kentucky Department of Revenue. The partnership must furnish Copies B and C to the members by the 15th day of the fourth month following the close of the taxable year. Form PTE-WH is available on the Kentucky Department of Revenue's Web site at www.revenue.ky.gov.

SCHEDULE K-1, PARTNERS' SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

Complete Schedule K-1 for each nonresident partner. For resident partners, complete only if different from federal Schedule K-1. Schedule K-1 (Form 765) shows each partner's separate share of items to be reported on their individual income tax return. If required, this form must be prepared in triplicate for each partner. One copy of each K-1 must be attached to Form 765 filed with the Kentucky Department of Revenue. One copy must be retained with the copy of the partnership return as a part of the partnership's records. One copy with instructions must be given to each partner.

Enter the name, address and identifying number of the partner, and the partnership. Schedule K-1 (Form 765) must be completed and given to each partner on or before the day on which Form 765 is filed with the Department of Revenue. Complete items A, B, C, D, E and F, and enter the distributive share of each item listed.

Photocopies of Schedule K-1 (Form 765) may be used in lieu of the official schedule printed by the Revenue Cabinet provided the photocopies are on bond paper of at least 16 pounds and are of good quality. You may find it more convenient to make photocopies of the schedule than to order the schedule from the department. **If photocopies are made, be sure to give each partner a copy of the instructions for Schedule K-1 (Form 765) included on the reverse side of the official schedule.** Prior approval from the department to use photocopies of Schedule K-1 (Form 765) is not required.

Nonresident Partners' Taxable Percentage—Item D(2) must be completed for nonresident partners. To complete Item D(2) the partnership must enter, in the space provided, its percentage of business in Kentucky. A partnership, which has all of its property and payroll within Kentucky, must enter 100 percent.

For Qualified Investment Partnerships Only—Item D(2), the percentage for nonresident partners is zero (0). Schedule K-1 does not need to be completed for nonresident partners, however, a copy of the federal K-1 must be attached for each nonresident partner.

ASSISTANCE—Additional information or assistance may be obtained by contacting the Department of Revenue, Frankfort, Kentucky 40620, (502) 564-4581 or from a Telecommunication Device for the Deaf (TDD), call (502) 564-3058. Assistance may also be obtained from any Taxpayer Service Center located in the following cities: Ashland, Bowling Green, Corbin, Florence, Frankfort, Hopkinsville, Louisville, Owensboro, Paducah and Pikeville.

PTE-WH 40A200 (10-04)		KENTUCKY NONRESIDENT INCOME TAX WITHHOLDING ON NET DISTRIBUTIVE SHARE INCOME		For Taxable Year Ended ___ / ___
(1) Pass-through entity's FEIN	(5) Kentucky net distributive share income subject to withholding00
(2) Pass-through entity's name, address and ZIP code	(6) Tax before credit (line 5 multiplied by .06 (6%))00
	(7) Enter credits (see instructions)00
	(8) Kentucky income tax withheld00
(3) Member's Social Security number	Copy A—For Kentucky Department of Revenue			
(4) Member's name, address and ZIP code				

740NP-WH 40A201 (10-04)		KENTUCKY NONRESIDENT INCOME TAX WITHHOLDING ON NET DISTRIBUTIVE SHARE INCOME TRANSMITTAL REPORT	For Taxable Year Ended ___ / ___
(1) FEIN	(5) Number of nonresident members subject to withholding		
(2) Name of Partnership, S Corporation, LP, LLP, or LLC	(6) Kentucky net distributive share income subject to withholding		.00
Street Address	(7) Tax before credit (line 6 multiplied by .06 (6%))		.00
City State ZIP Code	(8) Enter credits (attach schedule)		.00
(3) Check type of entity: <input type="checkbox"/> S Corp <input type="checkbox"/> GP <input type="checkbox"/> LP <input type="checkbox"/> LLP <input type="checkbox"/> LLC	(9) Kentucky income tax withheld (subtract line 8 from line 7)		.00
(4) Kentucky S Corporation Account Number			

Please send separate check(s) or money order(s) for payment of pass-through entity withholding and corporation income and license tax.

Make check(s) or money order(s) payable to Kentucky State Treasurer.

Mail to: Kentucky Department of Revenue, Frankfort KY 40619-0006.

I declare under the penalties of perjury that this return, including any accompanying schedules and statements, has been examined by me and, to the best of my knowledge and belief, is a true, correct and complete return.

Signature of general partner, member, elected officer or authorized person	Daytime telephone number	Date
---	--------------------------	------

Typed or printed name of preparer other than taxpayer	Identification number of preparer	Date
---	-----------------------------------	------

INSTRUCTIONS

A pass-through entity must complete this form and mail with payment to the Kentucky Department of Revenue by the 15th of the fourth month following the close of the taxable year. Copies A of Form PTE-WH, or approved substitute must be included.

1. Enter pass-through entity's Federal Identification Number (FEIN).
2. Enter pass-through entity's Name, Address and ZIP Code.
3. Check the box to indicate entity type. S Corp for S Corporation, GP for general partnership, LP for limited partnership, LLP for limited liability partnership and LLC for limited liability company.
4. Enter Kentucky S Corporation Account Number, if applicable.
5. Enter the number of members subject to withholding. Include those members whose net distributive share income is at least \$1,000 and for whom Form PTE-WH or approved substitute has been completed.
6. Enter here the total net distributive share income reported to members.
7. Multiply the amount on Line 6 by 6 percent and enter here.
8. Enter credits passed through to the members. List type of credit and amount on a separate schedule.
9. Subtract Line 8 from Line 7. This should match the amount of Kentucky income tax withheld on forms provided to members.